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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of)
)
Petition for)
Emergency Declaratory and)
Other Relief)

WC Docket No. 02-202

PETITION FOR EMERGENCY DECLARATORY AND OTHER RELIEF

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TABLE OF CONTENTS

Before the
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In the Matter of	)	
	)	
Petition for	)	WC Docket No. 02-202
Emergency Declaratory and	)	
Other Relief	)	

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Introduction and Summary

WorldCom's bankruptcy filing highlights more than ever the financial stress and upheaval of the telecommunications industry and the importance of ensuring continuity of service by limiting the financial fallout from the difficulties facing WorldCom and other firms in the industry. Achieving that vital goal means not only finding ways to continue delivering service to customers of bankrupt carriers but also ensuring that the financial health of other, remaining carriers is not dragged down by the demise of those whose business plans was inadequate. In particular, it is essential that surviving carriers be able to protect their ability to obtain payment for the services that they are required to provide to financially troubled companies.

The actual and potential demise of many leveraged, resale-based carriers now is being followed by the bankruptcy or other reorganization of even larger carriers with significant capital investments in their own facilities. In no small measure, these developments have resulted from the managed-competition framework introduced in the wake of the Telecommunications Act itself. While competitors in the telecommunications industry have always been both suppliers and customers of each others' services, the 1996 Act mandated an even closer financial nexus between carriers. As Chairman Powell recently acknowledged, "the FCC may have erred in the past by implicitly encouraging the formation of hundreds of Bell competitors without realizing how few of them would ultimately be able to survive."[1] This policy — coupled with individual carriers' flawed business plans — made the current shakeout inevitable.

In these circumstances, it is incumbent on the Commission to permit carriers to take the same types of flexible and expeditious measures that firms in other industries may take when faced with similar economic turmoil and uncertainty. Doing so will be a key part of restoring customer and investor confidence, stabilizing and regularizing the transactional currents, and bringing certainty to what Chairman Powell has described as an "utter crisis."[2] On the other hand, denying these kinds of reasonable protections would force carriers to act as guarantors of their competitors' business plans by leaving them holding the financial bag while having to ensure continuity of service for customers.

The extent of potential harm to the entire industry, and the accompanying risk of a decline in quality of service, are substantial. It therefore is critical that carriers be able to take reasonable steps to limit the financial fallout flowing from the continuing difficulties of WorldCom and other firms in the industry. In light of the current industrywide crisis, the Commission should allow carriers to protect themselves — and indeed should aid carriers in so doing — in the ways set forth below, thereby preventing further damage to the industry.

To these ends, Verizon urges the Commission to declare that it will adhere to the following principles and to provide clear guidelines to the industry that allow carriers to protect themselves from the industrywide financial turmoil:

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[1] Yochi J. Dreazen, *FCC's Powell Says Telecom 'Crisis' May Allow a Bell to Buy WorldCom*, Wall St. J., July 15, 2002, at A1.

[2] *Id.*

The Commission will:

- permit carriers expeditiously to revise their tariffs to require advance payments, security deposits, and shorter notice periods where necessary to ensure adequate assurance of payment by their customers;

- inform bankruptcy courts that carriers should receive payment in advance or other similar protections to obtain adequate assurance of payment for services provided during the pendency of their customers' bankruptcy proceedings;

- confirm that carriers wishing to receive the benefits of existing service arrangements of bankrupt carriers must, consistent with bankruptcy law (and binding federal tariffs), pay a cure of prior indebtedness on those services; and

- direct competitive local exchange carriers ("CLECs") to provide the information needed successfully to coordinate carrier-to-carrier transfers.

Of course, any meaningful resolution of the financial issues confronting the industry also ultimately requires restoring prices to levels that reflect the true risk that carriers face in the market, and that allow recovery of the extraordinary costs that have been imposed on them as a result of the requirement to serve carriers with financial difficulties. Doing so is critical to restore investment incentives and reinvigorate this critical sector of the nation's economy. As an initial matter, however, it is vital to take the steps outlined here in order to limit the problem from spreading further.

These steps are fully consistent with ensuring continued service for distressed carriers' end-user customers. Verizon will do all in its power to ensure that end-user network utilization will not be unduly harmed during what is sure to be a challenging and delicate period for both the bankrupt carriers and Verizon. We are sensitive to and in agreement with the Commission's overall policy goal of ensuring continuity of service to residential, business, and governmental consumers alike. But a critical component of ensuring continuity of service entails preventing the financial plight of some carriers from undermining the stability of the industry as a whole.

And the measures we propose here are designed to provide against precisely that eventuality, which obviously would harm both industry and consumers.

I. The Commission Should Allow Carriers To Revise Tariffs To Ensure Against Nonpayment.

Verizon plans very shortly to file revised tariffs to protect itself further from the harms that would flow from the inability of significant numbers of CLECs and IXCs to pay their bills. Specifically, Verizon's revised tariffs will require customers to comply with additional safeguards if they either have poor payment performance or demonstrate objective indicia of credit risk, such as downgrades in credit ratings to below investment-grade levels or the initiation of voluntary or involuntary bankruptcy proceedings. These new safeguards will consist of frequent (and therefore smaller) advance payments, security deposits (or alternatively letters of credit), and abbreviated notice periods for delinquent customers in order to protect against rapid increases in the amount of the delinquencies. These features are designed to provide reasonable levels of protection to Verizon, and at the same time to minimize the size of the deposits and payments that distressed carriers will have to make at any one time. With the increasing numbers of CLECs and other carriers in financial distress and even bankruptcy, these protections are essential to the future health of Verizon and the continuity of reliable service to its customers.

In the past, the Commission has been receptive to such tariff changes, and it should be so here. Verizon's revised tariff provisions will be fully consistent with the types of tariff revisions that the Commission has allowed local carriers to implement to reduce their risk of loss under circumstances similar to those facing the telecommunications industry today. *See, e.g.*, Memorandum Opinion and Order, *Annual 1987 Access Tariff Filings*, 2 FCC Rcd 280, 290 App. A (1986), where the Commission approved a reduction in BellSouth's notice period for discontinuance in light of the bankruptcy of "some" IXCs. BellSouth had explained that its policy of requiring a deposit where a customer had a "proven history of late payment" — identical to Verizon's current tariff — "do[es] not address *all* situations including those in which an [IXC] has sought bankruptcy . . . ." *Id.* (emphasis in original).

Moreover, as the Commission has noted, Verizon is entitled to require of delinquent customers advance payments and deposits, in appropriate circumstances, as the two serve different functions; "[t]he advance payment serves as an initial payment to guarantee service and to demonstrate a genuine interest in facilities; it is not a 'deposit' which is retained by the LEC [as provided in the tariff] or until the discontinuance of service." Order Designating Issues for Investigation, *Annual 1985 Access Tariff Filings*, CC Docket No. 86-125, Phase II (rel. June 9, 1986), 1986 WL 291913 (F.C.C.). For this reason, the Commission has expressed its unwillingness "to second-guess a carrier's decision, with respect to a particular customer, to impose deposit, advance payment, or other security arrangements provided for in its tariff." Memorandum Opinion and Order, *Affinity Network Inc. v. AT&T*, 7 FCC Rcd 7885, 7885 ¶ 3 (1992). To the extent that carriers find that present circumstances demand similar tariff revisions, the Commission should, consistent with its previous determinations, approve such revisions.

Further, the Commission should approve such tariff revisions with maximum expedition. Delay in Commission decisionmaking often is as costly to carriers as an adverse decision. For example, because the Commission has delayed issuing its decision on interim payphone compensation, WorldCom has never paid Verizon (or other carriers) the tens of millions of dollars that it has owed them since 1997. Now Verizon will need to file a claim in the WorldCom bankruptcy proceeding and, because the Commission has not yet ruled, WorldCom will likely dispute the claim. Because the claim is not liquidated, there is likely to be litigation that may delay WorldCom's efforts to reorganize and lead to increased legal expense for all parties. If the Commission had promptly issued its decision, WorldCom would have had to pay these debts prior to declaring bankruptcy, and the remaining carriers would not have the risk of loss they now face. Other examples of costly regulatory delay abound: to cite just one prominent example, a number of states have yet to implement the Commission's *Reciprocal Compensation Order.* Delay on these matters has directly contributed to the impact of carrier bankruptcies on Verizon and other carriers. And while the effect of these problems now cannot be entirely avoided, allowing carriers to take reasonable protective measures can help to limit the financial impact of other problems going forward.

II. The Commission Should Support ILECs' Efforts in the Bankruptcy Courts To Obtain Adequate Assurance of Payment for Service Rendered to Customers in Bankruptcy.

In some prior bankruptcy proceedings, the Commission has advocated that carriers be required to ensure continuity of service and a reasonable transition period for customers to find new carriers. The Commission has not, in many instances, emphasized the equally important interest of carrier-suppliers to continue to receive payments throughout the bankruptcy process. Such a balanced presentation is critically important in the extraordinary circumstances currently facing the industry, as "[n]early every telecommunications company . . . is owed money by WorldCom, and will have difficulty collecting these debts as WorldCom shields itself from creditors under bankruptcy court rules." Simon Romero & Jonathan D. Glater, *WorldCom Bankruptcy Poses Financial Risks to Other Phone Companies*, N.Y. Times, July 22, 2002, at A12. The Commission should therefore unequivocally support, *in any bankruptcy court proceedings in which it participates*, the right of carriers such as Verizon to receive payment in advance (or other measures such as security deposits) in order to obtain assurance of payment for the services that they continue to provide.

Bankruptcy courts generally recognize that suppliers that continue to provide service during the pendency of a bankruptcy are entitled to advance payment or other assurance of compensation under 11 U.S.C. § 366(b). *See, e.g., Va. Elec. & Power Co. v. Caldor, Inc.-NY*, 117 F.3d 646 (2d Cir. 1997). But those courts possess broad discretion in providing assurance of payment, *see id.*, 117 F.3d at 650, and in some cases they have concluded that they can provide adequate assurances of payment merely by allowing suppliers to terminate service to the debtor in the event of a default. Because industry regulators wish to avoid abrupt termination of service, however, they often seek to prevent carriers from terminating service.[3/] This interplay between the regulators' public policy goals and the court's views on adequate protection can result in a stalemate, in which the regulators nullify the only step carriers are authorized by the court to take to assure payment. As a result, creditor carriers are left with no viable means of ensuring payment for their services. The Commission can play a pivotal role in redressing this dilemma and ensuring that the interests of the telecommunications industry as a whole are adequately represented.

Specifically, the Commission should support the right of carriers to truly adequate assurance that they will receive payment for services actually provided — advance payment throughout. Under section 366 of the Bankruptcy Code, utilities must continue to provide the bankrupt service for the first 20 days after bankruptcy is declared (this time period is routinely extended to 60 or 90 days). Section 366 also gives utilities the corresponding right to adequate

[3/] In the meantime, other carriers are fully aware of and willing to exploit the fact that companies such as Verizon have been compelled to provide them service. WorldCom, for example, reportedly has been attempting to come current with its so-called "critical trade vendors" before paying bills to Verizon and its other creditors. Shawn Young, Carrick Mollenkamp, *et al., WorldCom Plans Bankruptcy Filing*, Wall St. J., July 22, 2002, at A3. Those other critical vendors, of course, do not share the same compulsory service obligations as Verizon and other local carriers.

assurance that they will be paid, including through advance payment. Giving effect to this right does not jeopardize continued service to end users (e.g., customers of bankrupt carriers); on the contrary, that goal is affirmatively furthered by ensuring that bankrupt carriers pay for their use of other carriers' facilities in order to use those services.

III. The Commission Should Ensure That Purchasers of Bankrupt Carriers' Existing Service Arrangements Comply with the Cure Requirements of Bankruptcy Law.

Some carriers that purchase carrier assets, including customer accounts, in a bankruptcy have sought to circumvent the basic principles of bankruptcy law by claiming that the Communications Act permits them to receive the benefit of and assume the bankrupt carrier's existing service arrangements without curing the debt on those arrangements. This practice finds no support in the Communications Act. And it will, if permitted, cause grave harm to carriers that provide service to bankrupts, because it will deprive those carriers of the rights enjoyed by other suppliers that provide service under executory contracts. As Verizon set forth more fully in its April 29, 2002 Counter-Petition for a Declaratory Ruling in WC Docket No. 02-80, the Commission should clarify that nothing in the Communications Act denies carriers serving bankrupt customers of carriers' well-established rights under the Bankruptcy Code (and binding federal tariffs) to obtain a cure of prior indebtedness from carriers that receive the benefit of the bankrupt's existing service contracts.

Section 365 of the Bankruptcy Code articulates a core bankruptcy principle: a debtor must cure any defaults as a condition precedent to the assumption (and assignment) of any executory contract. When a contract is assigned to a purchaser, the purchaser becomes liable for the indebtedness and must provide a cure. *See* 11 U.S.C. §§ 365(b)(1)(A), 365(f)(2). This cure requirement under section 365 reflects a sound congressional policy that allows creditors to negotiate a cure of pre-petition debts in return for further performance of executory contracts.

On its face, section 365 applies to *all* executory contracts, with no exception for telecommunications service arrangements. Therefore, if a carrier wishes to receive the benefit of the debtor's pre-existing service arrangements without the burden and potential delay of ordering its own replacement facilities, the carrier should be considered to have taken an assignment for purposes of bankruptcy law and the assignee carrier must assume the outstanding indebtedness and negotiate a cure. If the debtor rejects existing service arrangements in the bankruptcy proceedings, but a purchasing carrier then chooses to take over existing service arrangements, the carrier receiving the benefits of those arrangements must comply with tariff provisions requiring it to pay outstanding indebtedness on those service arrangements.

It is settled law that the Commission must harmonize its policies under the Communications Act with the Bankruptcy Code. *See, e.g., LaRose v. FCC*, 494 F.2d 1145 (D.C. Cir. 1974). The requirements of section 365 are consistent with the relevant provisions of ILECs' federal tariffs that govern assignments and transfers. Giving effect to the plain meaning of section 365 does not require interruption of service or undermine other policy goals of the Communications Act — it simply requires that a purchaser of CLEC assets out of bankruptcy make a timely choice as to which of its options it will pursue and provide appropriate notice to customers.

In sum, carriers have three options: (1) assume the contract in bankruptcy (and provide a cure under section 365); (2) assume the contract pursuant to the assumption provisions included in the tariffs of Verizon and other carriers (these provisions also require a cure of indebtedness); or (3) purchase a new service arrangement and transfer the customer using the normal carrier-to-carrier transfer process that all other carriers use (no cure is required and, if sufficient notice is provided, such transfers need not result in protracted interruption of service).

Requiring buyers to cure if they wish to assume existing contracts will not discourage the purchase of CLEC assets. A purchaser will bid only what it believes the assets are worth, taking into account the obligation to cure unpaid amounts. In effect, the proceeds of the sale are reallocated, with more going to the underlying carriers and less to other creditors such as the debtor's bank lenders. In other words, less of the cost of an individual carrier's failed business must be absorbed by and internalized in the telecommunications industry. Compliance with carrier-to-carrier transfer procedures is the norm. To exempt a CLEC from those procedures merely because it purchased assets out of bankruptcy would give the purchasing CLEC an unfair advantage, and would create an incentive for debtors to collude with prospective purchasers to abuse the bankruptcy process to the detriment of the entire industry. It also may create an incentive for collusive bankruptcies designed to avoid cures that would otherwise have to be negotiated and paid.

IV. The Commission Should Direct CLECs To Provide The Information Necessary To Coordinate Carrier-to-Carrier Transfers.

One additional problem that has often arisen in the context of carriers transferring existing service arrangements is the failure of those carriers to coordinate their connect and disconnect orders with serving carriers such as Verizon, thereby requiring serving carriers to create additional circuit capacity where none is needed. If an order is not identified by the CLECs involved as a carrier-to-carrier transfer (or other necessary information is not provided), Verizon can do little to coordinate the transfer. In addition, Verizon itself then runs the risk of adding unnecessary new capacity to fill new orders and stranding existing investment in the process. These inefficiencies can be avoided, and the efficacy of the transfer process ensured, only if one of the LECs involved in the transfer assumes responsibility for forwarding the complementary connect and disconnect orders to serving carriers such as Verizon. In order to ensure that this process works properly with minimal service interruptions, CLECs must coordinate closely with each other, and coordinate with Verizon, and one of the transferring carriers should take the lead in forwarding the connect and disconnect orders to the serving carrier. Regardless of the new carriers involved, Verizon will do its part to help coordinate the transition in order to minimize the impact on customers.

The Commission should accordingly modify its discontinuance guidelines[4/] to mandate that a single CLEC assume the responsibility of coordinating end-user transfers with the ILEC in each and every mass migration. The logical default rule would be that the acquiring carrier become the responsible CLEC.

Conclusion

We are in the midst of an extraordinary time. No industry in the history of the United States has experienced the rapid loss of value that has occurred in the telecommunications sector in the past twelve months. The shake-out of competitors who either overreached or were lured into a highly capital-incentive market has vast consequences for consumers and the economy as a whole.

[4/] *See* 47 C.F.R. § 63.71.

We ask the Commission to take a balanced, sober approach to the vital details of how the wholesale failure of so many competitors is affecting the health of Verizon and similar carriers whose statutory duty is to service the public. The steps we have recommended are well within the Commission's authority and responsibility. We are confident that the Commission will embrace its central role in steering the industry back to health.

Respectfully submitted,

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